

ZAYRE



ANNUAL REPORT 1964

Financial Highlights

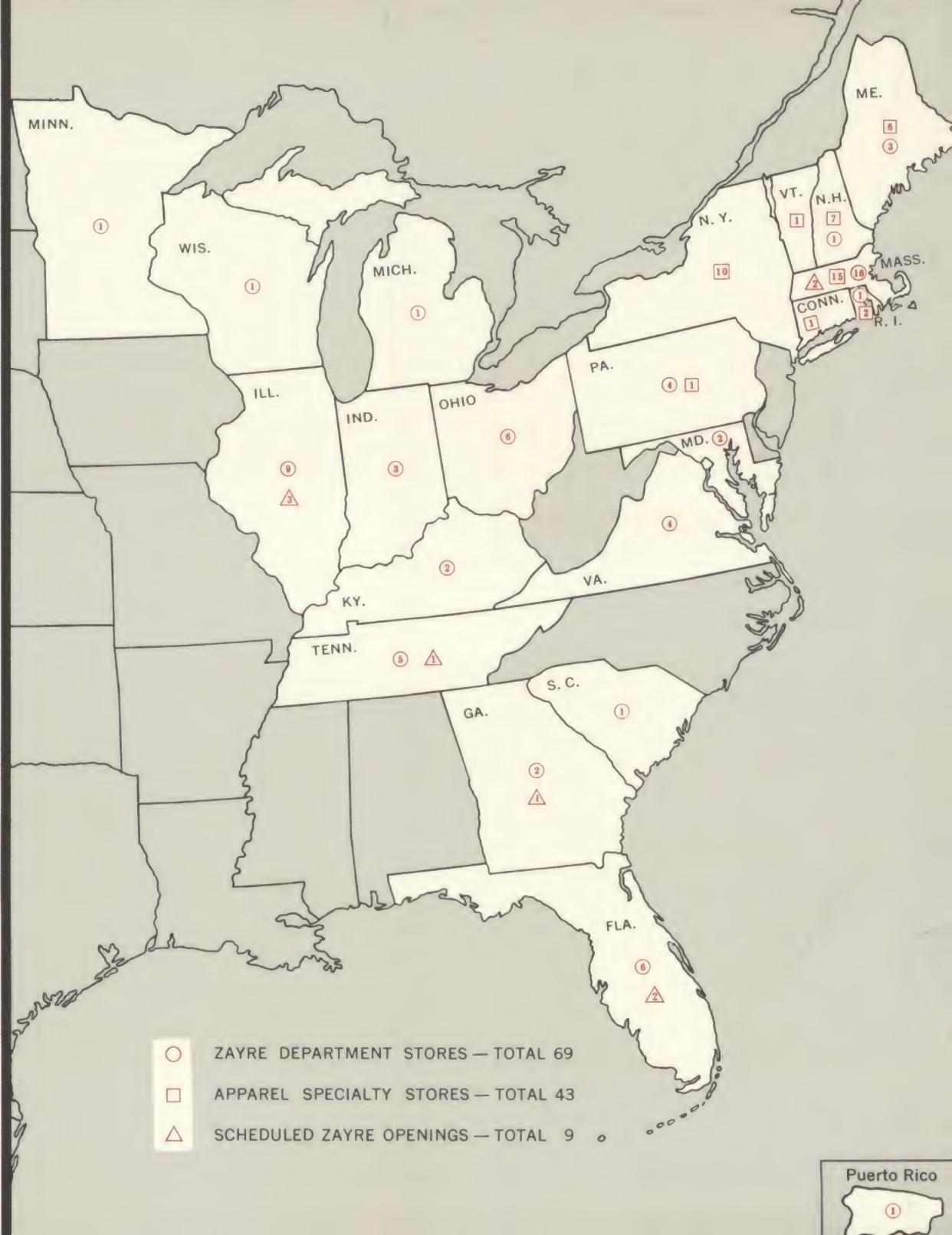
	1964	1963
Net Sales	\$162,278,267	\$122,810,651
Net Income	\$ 2,966,959	\$ 1,222,879
Working Capital	\$ 16,822,674	\$ 14,255,471
Stockholders Equity	\$ 12,610,044	\$ 9,616,295
Per Common Share:		
Net Income	\$1.76	\$.73
Stockholders Equity	\$7.49	\$5.72

THE COVER:

This is a night scene of the Zayre store located on busy U. S. 1 in Saugus, Massachusetts, a suburb of Boston. Zayre caters to suburban shoppers by providing ample free parking and daily evening shopping hours to 10:00 P.M.

ANNUAL MEETING:

Stockholders are urged to attend the annual meeting to be held at 11:00 A.M. on Tuesday, May 18, 1965 in the Directors' Room, The State Street Bank and Trust Company, 111 Franklin Street, Boston, Massachusetts.



Puerto Rico

Letter to Shareholders

To Our Shareholders:

It is a great pleasure to report that the fiscal year ended January 30, 1965 was the most successful one in the history of Zayre Corp.

Volume rose to a new high. Operating profits as a percentage of sales improved significantly. The result was an increase in earnings to a level more than double that of any previous year.

Sales and Earnings

Sales (excluding those of leased departments) rose to \$162,278,267 as compared with \$122,810,651 in the prior year. This was an increase of \$39,467,616, or 32.1 per cent.

Net income after taxes was \$2,966,959 compared with \$1,222,879 in the prior year. On a share basis, earnings rose to \$1.76 from 73¢ last year. The average number of shares outstanding was 1,681,799 in 1964 and 1,681,500 in 1963.

Net earnings give effect to charges for depreciation and amortization amounting to \$2,057,655, compared with \$1,995,303 last year.

Financial Position

During the past year, both the working capital of the company and its net worth have increased substantially.

Net working capital of Zayre Corp. and Operating Subsidiaries was \$16,822,674 at year end, an increase of \$2,567,203 over the prior period.

Stockholders' equity was \$12,610,044 in contrast to \$9,616,295 at the end of the prior period. This is equivalent to \$7.49 per share, up from \$5.72.

Return on average invested capital — shareholders' equity — was approximately 30 per cent.

Operating Resume

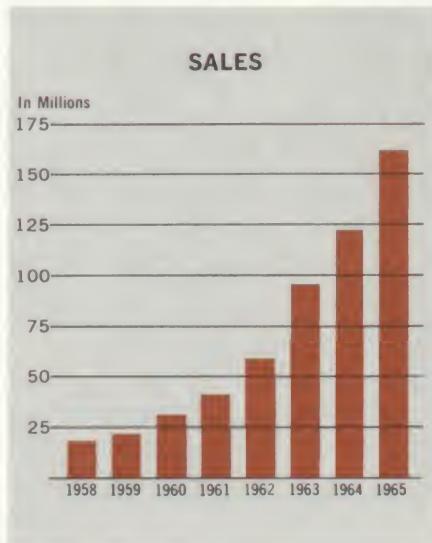
The increase in your company's earnings and its improving margin of profit on sales reflect many factors.

1964 was a strong year for the economy as a whole and for retailing in particular.

Consumer acceptance of the self-service department store concept has continued to grow. This popularity is due primarily to the emphasis placed on merchandise value and customer convenience. As a result, discount retailing has steadily increased its share of over-all retail volume.

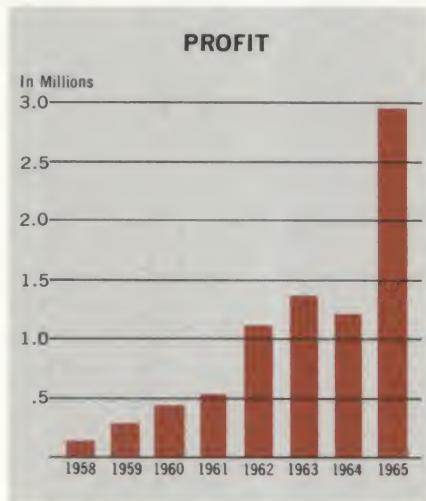
In the past ten years, the industry has grown to rival the conventional department store as the primary outlet for general merchandise. Industry volume is estimated at more than \$11 billion in 1964, up 20 per cent over 1963.

Our own rapid expansion during 1961 to 1963 placed Zayre Corp. among the leaders in this dynamic field of retailing, in terms of number of stores operated and sales volume. The



programs initiated in 1963 to improve gross margins, control operating expenses and increase volume through aggressive merchandising have increased the profitability of our stores.

The number of units in operation for more than two full years is continuing to increase. As we have noted before, it is at this point that our stores begin to contribute their full profit potentials.



These sixty-nine Zayre stores occupied 4,867,000 square feet of retail sales space, a sharp contrast to the 60,000 square feet of the first two Zayre stores in 1956.

The retail discount industry appears to be entering a new phase of growth. Our own real estate department is developing a large number of promising sites for new units to be opened in 1965 and 1966, primarily in markets where we already have stores.

During 1965, we expect to open ten to fifteen Zayre stores. We anticipate opening a similar number of stores in 1966; by 1967 there should be approximately one hundred Zayre stores in operation.

Expansion Program

Your management continues to follow a policy of sustained growth, tempered by prudent financial planning.

During 1964 we opened eight new Zayre stores, so that by year end sixty-nine Zayre stores were in operation. A complete listing is included in this report.

Included in the new units to be opened in 1965 are four stores, each approximately 130,000 square feet in size, previously operated under the CMA name; three in the Chicago area and one in Tampa, Florida. After extensive renovation, these units will be reopened under the Zayre name for Fall 1965. The large size of these stores makes possible the inclusion of a complete discount food supermarket to be operated by a regional food chain, plus additional departments beyond those normally carried in Zayre stores.

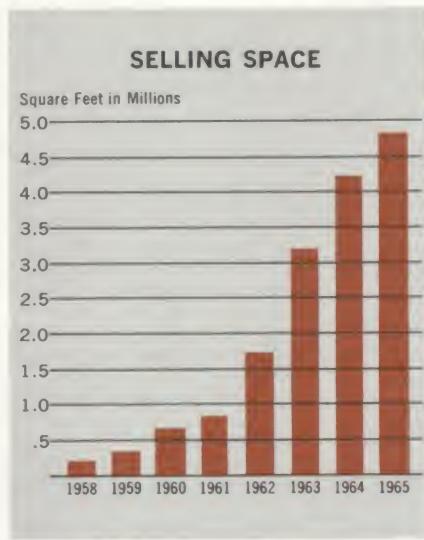
Two major steps in broadening the Company's owned lines of merchandise were concluded in February, 1965. We acquired the linen, domestics, and infant's departments previously operated by Archer Sales, Inc. in forty-seven Zayre stores and thirty-seven other stores. At the same time, we also acquired the stationery and greeting card departments formerly operated by Allan Enterprises, Inc. in sixty-eight Zayre stores. In both cases Zayre purchased primarily for cash the inventory, fixed assets and supplies. The acquisition of these departments is expected to add approximately \$17,000,000 annually to sales. We are pleased to welcome the experienced personnel of both organizations who have joined Zayre.

In a further important step to broaden the Company's owned lines of merchandise, we will operate our own health, beauty aids, notions, and candy departments in all new stores to be opened in the latter part of 1965, and thereafter.

Zayre Realty Corporation

The primary business of Zayre has been, and will continue to be, merchandising and operating self-service department stores.

In the past, we have leased all stores from others under terms which, in general, provide for rental payments sufficient to amortize the cost of the project over the life of the lease, plus payment of interest and a profit for the developer.



The improved financial position of the Company now makes it possible for Zayre to own and arrange long-term financing of selected projects without investing significant amounts of working capital. When this is done, the Company retains the lessor's profit, achieves a lower rental, and most significantly, retains the residual equity which remains in the property after it has been paid for fully.

To implement this program, we have organized a new wholly-owned subsidiary, Zayre Realty Corporation. In October, 1964 this corporation purchased the land and building at 12000 Beach Blvd., Jacksonville, Florida. Financing for this property has been arranged with two institutional lenders.

Zayre Realty has signed an agreement to acquire land in Atlanta, Georgia and also expects to acquire land in Augusta, Maine for the purpose of constructing store buildings thereon. Also, Zayre Realty has signed a contract for the purchase of the land and buildings of the three former CMA stores in Chicago, and the one in Tampa, Florida. All other stores presently planned for opening in 1965 will occupy leased buildings.

Operating Progress

We are pleased with the growth of our merchandising organization which has made considerable progress during the past year in adding to and enlarging our lines of merchandise.

Our advertising and sales promotion department has been strengthened. The many hard-hitting advertisements and the stronger promotional events developed have produced profitable volume.

Our extensive data processing installation provides complete and current data for management's use in controlling merchandise inventory and operating expenses. As our sales base has increased, we have achieved greater efficiency in the utilization of this equipment, thereby reducing the unit cost of each transaction processed.

A new program of internal audit has been established to review store operating procedures to assure the execution of management policies on a consistent basis throughout the chain.

During the year we added considerably to our experience in the use of charge accounts as a sales tool. If credit selling in self-service department stores increases in importance, we should be prepared to satisfy this consumer need. A complete credit card program is now available in thirteen Zayre stores. We will extend this program, which requires no cash investment by Zayre, on a selective basis, to those market areas where it can increase sales or is needed for competitive reasons.

During April, 1965, we closed our store in Rio Piedras, Puerto Rico. We found this market to be a growing one, but difficult to service. The opening of additional stores in that



area was essential if appropriate profits were to be achieved. This plan was dropped in view of the more attractive expansion opportunities for Zayre in other cities. Accordingly, arrangements were made for another retail chain, which already had stores in Puerto Rico, to assume the store lease and purchase the fixtures.

On May 12, 1964, the common stock of Zayre Corp. was admitted for trading on the American Stock Exchange. This major step was taken in order to broaden and improve the market for the Company's shares.

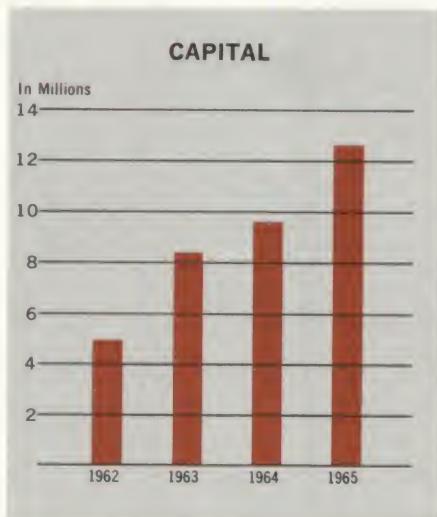
At year end the Company operated 43 women's and children's apparel specialty stores under the names Bell Shops and Nugent's. During 1964 we closed three of these stores and relocated one. The Apparel Specialty Stores Division accounted for approximately five per cent of over-all company sales volume in 1964.

Personnel

In May 1964 Anna Goldstein Levitman, Vice President and

Senior Merchandise Manager, was advanced to the corporate level with responsibility for the development of new lines of merchandise, both in the United States and abroad.

Maxwell Goldstein joined the Company in June 1964, as Senior Merchandise Manager responsible for the New York City fashion distribution center and the merchandising of all women's fashion apparel departments,



areas previously supervised by Mrs. Levitman. Subsequently, Mr. Goldstein was elected a Vice President of Zayre Corp.

Our store executive training program has proven to be a vital source of management talent, a most significant factor in a field of retailing as new as ours. Over one hundred and twenty-five qualified executives have completed the program over the past several years and fill key operating positions as managers, assistant managers, and district supervisors. At the present time over forty executives are in training in connection with our current expansion program.

The Future

We look forward to the future with confidence.

The vigorous and vital national economy should make 1965 another favorable year for retailing.

Our faith in Zayre's profitable future growth is buttressed by our established financial resources, the support of our seasoned organization, and our experience as merchandisers.

Once again, it is a genuine pleasure to thank our growing family of Zayre employees, now numbering over 6,000, whose invaluable contributions have been, and are, so essential to our continuing success.

Respectfully submitted,

MORRIS FELDBERG,
Chairman

STANLEY H. FELDBERG,
President

April 9, 1965



**ZAYRE CORP.
and Operating Subsidiaries**

**Eight-Year
Summary of Progress**

Fiscal Year Ended Last Saturday in January	1965	1964	1963	1962	1961	1960	1959	1958
OPERATING DATA:								
Net Sales (excluding sales of leased departments)	\$162,278,267	\$122,810,651	\$96,431,611	\$59,165,743	\$41,942,064	\$31,372,742	\$22,001,541	\$18,516,155
Earnings Before Federal Income Taxes (1)	5,146,959	2,079,179	2,359,594	2,003,736	1,062,697	903,148	517,338	201,776
Net Income (1)	2,966,959	1,222,879	1,374,494	1,126,736	541,697	441,148	295,338	143,776
Average Number of Shares Outstanding	1,681,799	1,681,500	1,564,833	1,506,500	1,506,500	1,506,500	1,506,500	1,506,500
Earnings per Share (1)	\$1.76	\$.73	\$.88	\$.75	\$.36	\$.29	\$.20	\$.10
STORES IN OPERATION:								
Zayre Department Stores	69	61	47	27	14	11	6	4
Apparel Specialty Shops	43	46	48	52	59	61	64	70
FINANCIAL POSITION:								
Current Assets	\$ 27,977,499	\$ 25,719,556	\$18,288,036	\$11,467,893				
Current Liabilities	11,154,825	11,464,085	8,234,805	6,550,961				
Working Capital	16,822,674	14,255,471	10,053,231	4,916,932				
Stockholders' Equity	12,610,044	9,616,295	8,393,416	4,957,270				
Number of Shares Outstanding at Year End	1,683,850	1,681,500	1,681,500	1,506,500				
Stockholders' Equity per Share	\$7.49	\$5.72	\$4.99	\$3.29				

(1) Income for fiscal 1963 and prior years includes pro forma adjustments which give effect to the ownership of assets acquired from Feldberg Five Fund on March 1, 1962.

ZAYRE CORP. STORES

At the close of the fiscal year, Zayre Corp. operated 69 self-service department stores with a total gross area of 4,867,000 square feet.

Zayre will open from 10 to 15 new stores during 1965, most of them in markets where we already enjoy consumer acceptance.

Zayre opened its third store in both Indianapolis, Indiana and Pittsburgh, Pennsylvania during 1964. These areas, as shown on the maps at the right, are typical major metropolitan marketing areas where Zayre has penetration in depth.

Florida — MIAMI (3) Coral Way, Hialeah, North Miami Beach — TAMPA — JACKSONVILLE (2) Normandy Blvd., Beach Blvd.

Georgia — ATLANTA (2) Stewart Avenue, Buford Highway

Illinois — CHAMPAIGN — CHICAGO (6) Des Plaines, Forest Park, Joliet, Markham, Oaklawn, Columbus Avenue — ROCK ISLAND — SPRINGFIELD

Indiana — INDIANAPOLIS (3) Pendleton Pike, South East Highway, East 10th Street

Kentucky — LOUISVILLE (2) Bardstown Road, Dixie Highway

Maine — BANGOR — PORTLAND — PRESQUE ISLE

Maryland — DISTRICT OF COLUMBIA (2) Silver Springs, Wheaton

Massachusetts — BOSTON (8) Beverly, Braintree, Cambridge, Medford, Natick, Roslindale, Saugus, Woburn — FALL RIVER — HYANNIS — LOWELL — PITTSFIELD — SPRINGFIELD (3) Boston Road, Agawam, Chicopee — WORCESTER

Michigan — KALAMAZOO

Minnesota — MINNEAPOLIS

New Hampshire — MANCHESTER

Ohio — CINCINNATI (2) Paxton Avenue, Princeton Pike — CLEVELAND (3) North Olmsted, Ridge & Denison, Warrensville Heights — COLUMBUS

Pennsylvania — PITTSBURGH (3) McKnight Road, Monroeville, McKeesport — WILKES-BARRE

Puerto Rico — RIO PIEDRAS

Rhode Island — EAST PROVIDENCE

South Carolina — COLUMBIA

Tennessee — KNOXVILLE — MEMPHIS — NASHVILLE (2) Gallatin Road, Murfreesboro Road — CHATTANOOGA

Virginia — DISTRICT OF COLUMBIA (2) Alexandria, Falls Church — PORTSMOUTH — RICHMOND

Wisconsin — RACINE

Apparel Specialty Stores

Connecticut — NORWICH

Maine — AUGUSTA — BIDDEFORD — LEWISTON — PORTLAND — ROCKLAND — SKOWHEGAN

Massachusetts — BOSTON — FALL RIVER — FRAMINGHAM — GLOUCESTER — LAWRENCE (2) — LOWELL — LYNN — MALDEN — PITTSFIELD — QUINCY — SALEM — SPRINGFIELD — TAUNTON — WORCESTER

New Hampshire — BERLIN — CONCORD — KEENE — MANCHESTER (2) — NASHUA — ROCHESTER

New York — AUBURN — ELMIRA — ENDICOTT — GLEN FALLS — JAMESTOWN — KINGSTON — NIAGARA FALLS — OLEAN — POUGHKEEPSIE — WATERTOWN

Pennsylvania — ERIE

Rhode Island — NEWPORT — PAWTUCKET

Vermont — NEWPORT

Zayre Openings Now Scheduled

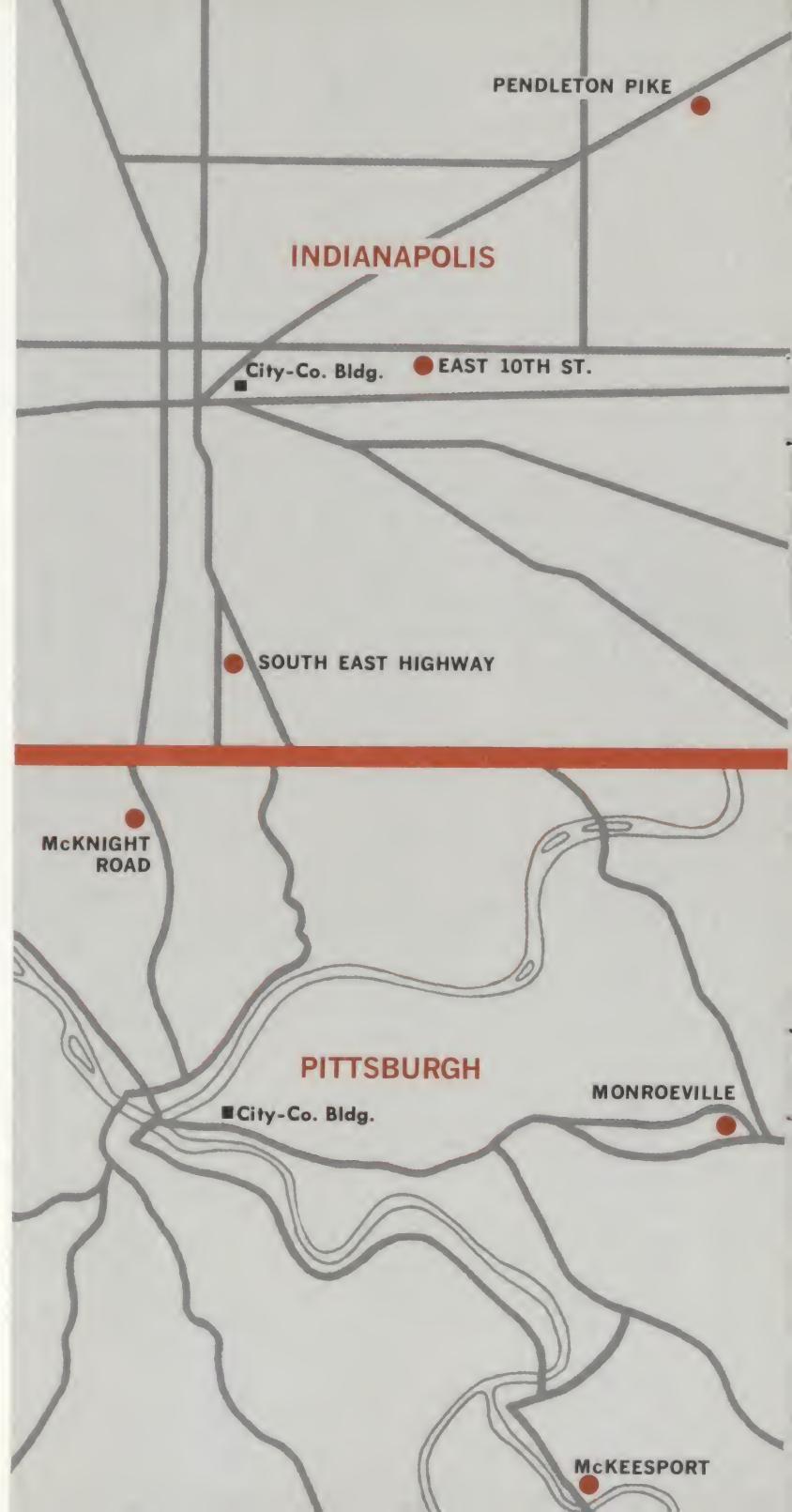
Florida — FORT LAUDERDALE — TAMPA

Georgia — ATLANTA

Illinois — CHICAGO (3)

Massachusetts — AMHERST — GREAT BARRINGTON

Tennessee — MEMPHIS





EAST 10TH STREET



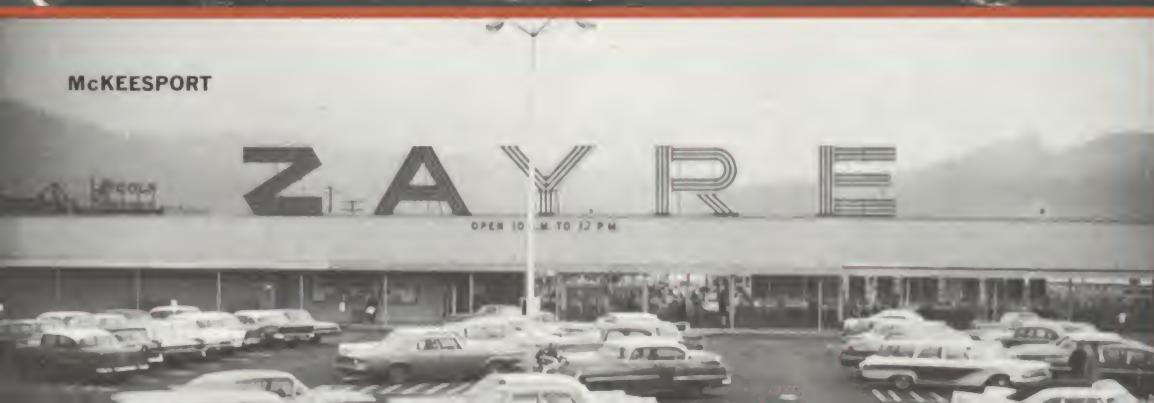
SOUTH EAST HIGHWAY



McKNIGHT ROAD



McKEESPORT



MONROEVILLE





The wide assortments of up to the minute fashion-right merchandise easily available for inspection and comparison make shopping a joy at Zayre. Self-service helps lower the costs of doing business, and these savings are passed on to the consumer, whose dollars buy more at Zayre.

The illustration below gives a good idea of the extensive scope of the merchandise available at Zayre. Air-conditioned, with speedy checkout counters, all Zayre stores are located on main highways and provide ample free parking space for customers.



HOW ZAYRE SERVES THE COMMUNITY

Zayre stores serve the communities in which they are located by contributing to better living standards, providing employment opportunities, and participating in local civic activities.

The Zayre one-stop discount shopping concept introduced in 1956 helped to trigger a revolution in department store merchandising. Today, more than a million modern suburban families satisfy their apparel, home and recreation needs economically and speedily at the 69 Zayre self-service retail department stores.

They prefer to shop Zayre because they get value, reflected in lower prices, without sacrificing quality.

The convenience of wide assortments of popular priced merchandise, all under one roof, and the easy informality of shopping at the typical Zayre store, have great appeal to suburban families and stimulates shopping by family groups.

Zayre is a good neighbor. Its stores take part in many civic activities and sponsor many community projects like this Zayre float in a Columbia, S. C. event. Other community efforts include sponsorship of athletic teams, benefit style shows, children's United Nations pageants and other worthwhile public affairs.



Zayre is continually widening its lines of merchandise and opening new service departments like this beauty salon shown above. Other recent innovations in many stores include automotive service centers, food markets, garden shops, and charge card plans. Zayre prides itself on keeping pace with the needs of its customers.



Fashion-right merchandise is carefully inspected before shipment to assure quality and performance. The scene above is from the New York City fashion distribution center.



Zayre employs over 6,000 men and women in the 75 communities in which it operates. Typical of the many training opportunities offered is the store executives refresher course at the Natick headquarters (below).





ZAYRE CORP.
and Operating Subsidiaries

CONSOLIDATED

	ASSETS	Jan. 30, 1965	Jan. 25, 1964
CURRENT ASSETS:			
CASH		\$ 3,277,386	\$ 2,104,930
U. S. TREASURY BILLS			999,525
ACCOUNTS RECEIVABLE		1,486,502	1,384,358
MERCHANDISE INVENTORIES, at the lower of cost (retail method) or market		21,645,603	20,302,914
DU ^E FROM LEASING SUBSIDIARIES (note B)		707,437	47,434
PREPAID EXPENSES		860,571	880,395
TOTAL CURRENT ASSETS		<u>27,977,499</u>	<u>25,719,556</u>
EQUITY IN WHOLLY OWNED UNCONSOLIDATED LEASING SUBSIDIARIES (note B)		1,156,420	652,088
PROPERTY, EQUIPMENT, AND LEASEHOLD IMPROVEMENTS, at cost		1,917,398	1,938,653
Less accumulated depreciation and amortization		<u>1,129,013</u>	<u>1,092,957</u>
		788,385	845,696
PREOPENING EXPENSES, at amortized cost (note D)		244,171	409,675
DEFERRED CHARGES AND OTHER ASSETS		545,459	552,878
		<u>\$30,711,934</u>	<u>\$28,179,893</u>

The accompanying notes are an integral part of the financial statements.

BALANCE SHEETS

LIABILITIES	<i>Jan. 30, 1965</i>	<i>Jan. 25, 1964</i>
CURRENT LIABILITIES:		
CURRENT INSTALMENTS OF LONG-TERM DEBT	\$ 128,684	\$ 83,120
ACCOUNTS PAYABLE	5,728,941	6,950,269
SALES TAXES, PAYROLL WITHHOLDINGS, AND COLLECTIONS FOR LEASED DEPARTMENTS	1,580,440	1,850,403
ACCRUED EXPENSES	1,774,400	1,935,763
FEDERAL INCOME TAXES	1,942,360	644,530
TOTAL CURRENT LIABILITIES	<u>11,154,825</u>	<u>11,464,085</u>
LONG-TERM DEBT, exclusive of current instalments (note C)	6,827,958	6,956,642
DEFERRED FEDERAL INCOME TAXES (note D)	119,107	142,871
COMMITMENTS (note F)		
STOCKHOLDERS' EQUITY		
COMMON STOCK, par value \$1, authorized 3,000,000 shares, issued and outstanding 1,881,178 shares (notes G and H)	1,881,178	1,878,828
ADDITIONAL PAID-IN CAPITAL	2,371,949	2,347,509
RETAINED EARNINGS (note C)	8,646,917	5,679,958
Less 197,328 shares of stock in treasury, at cost	<u>12,900,044</u> <u>290,000</u>	<u>9,906,295</u> <u>290,000</u>
	<u>12,610,044</u>	<u>9,616,295</u>
	<u><u>\$30,711,934</u></u>	<u><u>\$28,179,893</u></u>

The accompanying notes are an integral part of the financial statements.



ZAYRE CORP. and Operating Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME

	<i>Fiscal Years Ended</i>	
	<i>Jan. 30, 1965</i>	<i>Jan. 25, 1964</i>
Net sales (excluding sales of leased departments)	\$162,278,267	\$122,810,651
Rentals from leased departments, net of estimated allocated store expenses	1,614,309	1,354,568
Other income	312,202	328,887
	<u>164,204,778</u>	<u>124,494,106</u>
Cost of sales and operating expenses	158,387,626	121,674,976
Depreciation and amortization	731,829	874,408
Interest expense	546,496	390,200
	<u>159,665,951</u>	<u>122,939,584</u>
Income before provision for federal income taxes	4,538,827	1,554,522
Provision for federal income taxes (note E)	1,976,200	657,100
	<u>2,562,627</u>	<u>897,422</u>
Net income of wholly owned unconsolidated leasing subsidiaries†	404,332†	325,457†
Net income	<u>\$ 2,966,959</u>	<u>\$ 1,222,879</u>

†After charges for:

Depreciation	\$1,325,826	\$1,120,895
Interest	505,139	455,474
Federal income taxes, principally deferred (notes D and E)	203,800	199,200

The accompanying notes are an integral part of the financial statements.

**CONSOLIDATED STATEMENTS
OF RETAINED EARNINGS**

	<i>Fiscal Years Ended</i>	
	<i>Jan. 30, 1965</i>	<i>Jan. 25, 1964</i>
Balance at beginning of year	\$5,679,958	\$4,457,079
Net income	2,966,959	1,222,879
Balance at end of year	<u>\$8,646,917</u>	<u>\$5,679,958</u>

**CONSOLIDATED STATEMENTS
OF ADDITIONAL PAID-IN CAPITAL**

Balance at beginning of year	\$2,347,509	\$2,347,509
Excess of net cash proceeds over par value of 2,350 shares of common stock issued upon exercise of stock options	24,440	_____
Balance at end of year	<u>\$2,371,949</u>	<u>\$2,347,509</u>

The accompanying notes are an integral part of the financial statements.

Notes to Consolidated Financial Statements

A — PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the financial statements of the parent company and all operating subsidiaries, all wholly owned. The parent company's investments in Zayre Leasing Corporation and Zayre Realty Corporation (the latter organized during fiscal 1965), wholly owned unconsolidated leasing subsidiaries, are included in the accompanying financial statements at an amount equal to their underlying net assets. If the leasing subsidiaries were consolidated in the accompanying statements, the assets and liabilities shown in note B would be included in appropriate captions in the consolidated balance sheets; consolidated net income would not be affected. All subsidiaries are consolidated in annual reports filed with the Securities & Exchange Commission.

B — SUMMARY OF NET ASSETS OF THE LEASING SUBSIDIARIES OF ZAYRE CORP.

	January 30, 1965	January 25, 1964
Property, equipment and leasehold improvements, net of accumulated depreciation and amortization of \$3,638,463 and \$2,313,390, respectively	\$11,471,211	\$10,270,481
Equipment promissory notes, interest 5% to 5 3/4%, maturing 1965 to 1969, including \$2,196,305 and \$1,651,462, respectively, due within one year	9,532,713	9,681,164
Cash	1,938,498	589,317
Other assets	545,714	474,553
	16,443	118,632
	<u>2,500,655</u>	<u>1,182,502</u>
Amounts due to Zayre Corp. and operating subsidiaries	707,437	47,434
Accounts payable and accrued expenses	169,139	213,963
Deferred federal income taxes (note D)	467,659	269,017
	<u>1,344,235</u>	<u>530,414</u>
Net assets — paid-in capital of \$200,000 and retained earnings	<u>\$ 1,156,420</u>	<u>\$ 652,088</u>

Zayre Leasing Corporation has commitments of approximately \$1,800,000 for the purchase of furniture and fixtures for new Zayre stores, distribution center, and offices.

Subsequent to January 30, 1965, Zayre Realty Corporation purchased land and a building for \$1,025,000 and purchased another store site for \$100,000 upon which it is committed to construct a \$600,000 building. Zayre Realty Corporation is also committed to buy three additional locations, as described in note F, and is currently negotiating with institutional lenders for mortgage financing of these commitments and of real estate owned at January 30, 1965.

C — LONG-TERM DEBT

Long-term debt, exclusive of current instalments, at January 30, 1965 consisted of the following:

6% promissory note, payable \$60,000 semi-annually, balance due April 1, 1976	\$ 1,320,000
5.8% promissory notes, payable \$250,000 annually commencing January 31, 1967 through January 31, 1978	3,000,000
5 1/2% subordinated notes, payable \$200,000 annually commencing January 15, 1968, balance due January 15, 1979	2,500,000
Other long-term debt	7,958
	<u>\$6,827,958</u>

The 5 1/2% subordinated notes are subordinated to the 6% and 5.8% promissory notes. A description of the stock purchase warrants issued in connection with the subordinated notes is set forth in note H.

Under provisions of the agreements governing long-term debt, no more than \$2,600,000 of retained earnings was available for dividends at January 30, 1965.

D — DEFERRED FEDERAL INCOME TAXES

Deferred federal income taxes arise from: (a) the use of an accelerated depreciation method for tax purposes whereas the straight-line method is used for financial reporting purposes; and (b) the deduction for tax purposes of preopening expenses in the year in which a store opens, whereas such expenses are amortized over a 12-month period for financial reporting purposes.

E — INVESTMENT CREDIT

The companies have reduced the provisions for current and deferred federal income taxes by the applicable investment credit. In the aggregate, \$308,000 of available investment credit was used to reduce provisions for federal income taxes in fiscal 1965 and \$194,000 in fiscal 1964. Approximately \$72,000 of unused investment credit is available for reduction of future taxes.

F — COMMITMENTS

Under long-term leases, expiring after fiscal 1968 (principally from 1978 to 1988), the companies are committed to pay minimum annual rentals of approximately \$7,300,000, exclusive of, in many instances, real estate taxes, insurance, maintenance and additional rentals based on sales. Additional minimum annual rent of approximately \$110,000 will be payable under a long-term lease for a store not yet opened.

Fixed annual rentals of approximately \$2,500,000 are payable to Zayre Leasing Corporation and Zayre Realty Corporation, wholly owned unconsolidated subsidiaries, under long-term leases, expiring principally in 1971, for the use of equipment, fixtures, leasehold improvements and a store building.

The parent company has guaranteed directly or indirectly the payment of Zayre Leasing Corporation's equipment promissory notes (see note B).

An agreement has been signed to lease three additional store buildings for twenty years at an annual rental of \$400,000 and, if and when title

can be delivered to Zayre Realty Corporation, to buy them for an aggregate cost of \$4,825,000 (see note B).

In two separate transactions during February, 1965, the Company purchased substantially all of the assets (principally merchandise inventories), but assumed none of the liabilities, of two companies which operated leased departments in Zayre stores and other discount chains. The aggregate purchase price of approximately \$3,700,000 is payable, except for a \$175,000 three-year 5% non-negotiable note, in cash instalments through November, 1965.

G — STOCK OPTIONS

Under its 1962 Key Employees Stock Option Plan, the Company had reserved 47,650 shares of its common stock for issuance to employees. Five-year options for the purchase of 37,850 shares at an aggregate price of \$406,175 (95% to 100% of market price on the dates of grant in 1962 and 1964) were outstanding at January 30, 1965. The options are exercisable one year after the date of grant, generally in four equal cumulative annual instalments. Options for the purchase of 2,350 shares for an aggregate of \$26,790 were exercised during fiscal 1965 and options as to 11,050 shares were exercisable at January 30, 1965. Subject to stockholder approval, the Company plans to adopt a new Stock Option Plan and to terminate the 1962 Plan except as to options outstanding thereunder.

H — STOCK PURCHASE WARRANTS

There were outstanding at January 30, 1965 Class A and Class B warrants for the purchase of 62,500 and 37,500 shares, respectively, of the Company's common stock. Through July 15, 1971, the purchase price at which they are exercisable is \$10 for Class A warrants and \$12.50 for Class B warrants. Both classes are exercisable thereafter at \$15 per share through January 15, 1979, when they expire. The exercise prices are subject to antidilution provisions and the number of shares which can be purchased under the warrants is subject to adjustment for recapitalizations and similar events. The Company has reserved 100,000 shares of its authorized common stock for the warrants. None of these warrants has been exercised.

LYBRAND, ROSS BROS. & MONTGOMERY

ACCOUNTANTS AND AUDITORS

COOPERS & LYBRAND
IN AREAS OF THE WORLD
OUTSIDE THE UNITED STATES

To the Board of Directors of

ZAYRE CORP.:

We have examined the consolidated balance sheet of Zayre Corp. and Operating Subsidiaries as of January 30, 1965, and the related consolidated statements of income, retained earnings, and additional paid-in capital for the fiscal year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the financial statements for the fiscal year ended January 25, 1964.

In our opinion, the accompanying financial statements present fairly the consolidated financial position of Zayre Corp. and Operating Subsidiaries at January 30, 1965 and January 25, 1964, and the consolidated results of their operations for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Lybrand, Ross Bros. & Montgomery

Boston, Massachusetts

April 2, 1965

BOARD OF DIRECTORS

MORRIS FELDBERG	<i>Chairman</i>
MAX FELDBERG	<i>Vice Chairman</i>
ABRAM BERKOWITZ	<i>Partner, Ropes & Gray</i>
STANLEY H. FELDBERG	<i>President</i>
SUMNER L. FELDBERG	<i>Treasurer</i>
NEWTON A. LANE	<i>Partner, Nathanson & Rudofsky</i>
MILTON L. LEVY	<i>Vice President</i>
MORRIS NATELSON	<i>Partner, Lehman Brothers</i>
BURTON S. STERN	<i>Vice President</i>

TRANSFER AGENTS

State Street Bank and Trust Company, Boston, Massachusetts
Irving Trust Company, New York, New York

REGISTRARS

The First National Bank of Boston, Boston, Massachusetts
The Chase Manhattan Bank, New York, New York

GENERAL COUNSEL
Nathanson & Rudofsky

SPECIAL COUNSEL
Ropes & Gray

AUDITORS

Lybrand, Ross Bros. & Montgomery
Goodman & Goodman

LISTING
American Stock Exchange

DISTRIBUTION CENTERS

Framingham, Mass. • Natick, Mass. • New York, N. Y.

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Chairman of the Board



MAX FELDBERG
Vice Chairman of the Board



STANLEY H. FELDBERG
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Assistant Treasurer



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Secretary



NORMAN LENOX
Assistant Secretary

ZAYRE CORP. ONE MERCER ROAD, NATICK, MASS.

